

---

## Update on Preparing Living Wills for Bank Holding Companies and Depository Institutions

By Joseph T. Lynyak III and Rodney R. Peck

---

*This analysis updates a previous memo and incorporates advice we have received from the Federal Reserve Board (“FRB”) and the Federal Deposit Insurance Corporation (“FDIC”) regarding the preparation of living wills for bank holding companies and banks required to comply by July 31, 2103 or December 31, 2013.*

---

In November 2011, the FRB and the FDIC adopted regulations requiring U.S. bank holding companies with consolidated assets exceeding \$50 billion to provide a resolution plan—commonly being referred to as a “living will.”

Because the asset tier structuring determines when a bank holding company (and possibly, its subsidiary bank(s)) must submit a living will, covered holding companies are required to submit their living wills on July 31, 2013 or December 31, 2013. (The largest bank holding companies have previously submitted their living wills on July 31, 2012.)

### **Living Will Requirements**

Living wills require extensive and detailed disclosure of a covered holding company’s structure and operations, with emphasis being placed on providing an analysis of the means by which the non-banking assets would either be recapitalized or else resolved under the federal Bankruptcy Code and the bank receivership provisions of the Federal Deposit Insurance Act. (Several other specialized U.S. insolvency laws may also be implicated.) In addition, for covered companies operating on an international basis, a discussion of the applicability of the receivership/insolvency laws in other jurisdictions may also be required.

The FRB and the FDIC have learned from their initial review of the living wills submitted by the largest holding companies in July of 2012 that the exercise of preparing a living will is useful not only because it provides a clear path to resolve an insolvent holding company and/or insured depository institution, but also because it provides both the U.S. regulators and the covered holding company or bank with a

structured approach at the corporate level for resolving an insolvent financial entity based upon the legal structure rather than the cross-corporate operations of the enterprise as a whole.

Specifically, bank holding companies generally operate based upon the implementation of business goals and not upon corporate structures and similar formalities. The “mapping” process envisioned by a living will permits the FRB and the FDIC to understand how the enterprise function can best be preserved by analyzing and determining how to preserve functionality across corporate members of an affiliated group that would be affected by the various insolvency regimes, should some or all members of a holding company family fail.

As noted above, the FDIC and the FRB have come to understand that the living will exercise is an iterative, ongoing process that will reoccur each year—with the announced intention that each year the level and quality of analysis will continually improve. (Of course, as the domestic and global financial system experiences or identifies new risks of loss, it is probable that at the time of each annual review of a holding company’s living will, the FRB or FDIC may require a new or different analysis be employed to enhance the value of the previous year’s living will analysis.)

The submission of living wills for the largest banking organizations has resulted in two broad categories that the FRB and the FDIC requires submitting organizations to address: The first is a recovery plan for a holding company family that may be in danger of failing but may recover, such as by obtaining additional capital, selling of assets or lines of business, etc. The second category is a resolution plan, which presents a coherent, organized pathway to liquidate or rehabilitate some or all corporate components of a holding company family that has failed and cannot continue to be operated except by utilizing the various applicable insolvency laws.

### **Categories of Holding Companies and Banks Covered by the Living Will Requirements**

A bank holding company with consolidated assets in excess of \$50 billion is covered by the living wills regulation (and is referred to in the living wills regulation as a “covered” company). As noted above, the very large bank holding companies with non-bank assets exceeding \$250 billion have previously submitted their living wills. The dates that the two remaining categories of covered bank holding companies must prepare and submit living wills by are as follows:

- *Bank holding companies with more than \$100 billion of non-bank assets but less than \$250 billion of non-bank assets—July 31, 2013.*
- *Bank holding companies with more than \$50 billion of consolidated assets but less than \$100 billion of non-bank assets—December 31, 2013.*

### **Content of Living Wills for Non-Bank Assets**

As a useful perspective, the exercise of preparing a living will involves analyzing how the various bankruptcy and insolvency laws applicable to the corporate family would impact a holding company, its depository institutions and affiliated companies. Based upon the following, a holding company must analyze its resolution options and focus on the resolution of the holding company and its non-bank assets under the U.S. Bankruptcy Code:

- Executive Summary
- Strategic Analysis
- Corporate Governance Relating to Resolution Planning

- Organizational Structure
- Management and Information Systems
- Interconnectiveness and Interdependencies
- Supervisory and Regulatory Information
- Contact Information

In addition to addressing the possible application of the various insolvency laws, a holding company must also describe the applicability of international insolvency laws on the holding company's non-U.S. assets, including the bank resolution laws of nations in which the holding company may conduct banking operations.

### **Content of a Living Will for a Holding Company's Depository Institution**

Subject to the limited exception described below, a holding company with an FDIC-insured depository institution with assets of \$50 billion or more (referred to in the regulation as a "covered insured depository institution" or "CIDI") must submit a companion living will to the FDIC that contains the following components:

- Executive summary
- Organizational structure of legal entities, core business lines and branch system
- Critical services
- Interconnectiveness to the parent company's organization
- Strategy to separate the CIDI from the parent company's organization
- Strategy for the sale or disposition of the deposit franchise, business lines and assets
- Analysis of the least costly resolution method
- Asset valuation sales
- Identification of major counterparties
- Off-balance-sheet exposures
- Collateral pledged
- Trading activities, derivatives and hedging
- Unconsolidated balance sheet of the CIDI and other material entity financial statements
- Payment, clearing and settlement systems
- CIDI capital structure and funding sources
- Affiliate transactions, exposures and concentrations
- Systemically important functions
- Cross-border elements
- Management information systems
- Intellectual property
- Corporate governance and CIDI contacts

Although the FDIC's authority to resolve an insolvent bank is fairly well understood by practitioners in the area, the integration of functions across a holding company enterprise requires separating bank activities from non-bank functions. Among other things, the FRB and FDIC have identified numerous areas where ownership or access to back-office operations, including rights to intellectual property, are critical to ensuring the continued functioning of a bank subsidiary.

### Limited Exception—An “Eligible Covered Company”

The living wills regulation provides an important but limited exception that permit a qualified holding company (called an “eligible covered company”) to file a streamlined living will, which is termed a “tailored living will.” A holding company qualifies as an eligible covered company if it meets *both* of the following two tests:

- The holding company has less than \$100 billion in non-bank assets; and
- The holding company's insured depository institution(s) comprise more than 85% of the holding company's consolidated assets.

If the holding company qualifies for this limited exception, instead of filing an extensive analysis that addresses in detail the recovery and resolution portions of the living will, it need only provide the introductory summary portions required for a living will, plus a limited strategic plan and interconnectivity and interdependency analysis, as well as regulatory supervision oversight information.

It is important to note two items should a holding company wish to qualify as an eligible covered company and hence make use of the limited exception discussed above.

First, the holding company must submit an application to the FRB and the FDIC no later than 270 days prior to the date the living will is required to be filed—which means that the application must be filed no later than the first week of April 2013.

Second, and more importantly, the FRB and FDIC staff with whom we have discussed this issue have emphasized that the granting of an exemption is entirely discretionary, and depends to a great degree on the clarity of the description of the holding company's operations as contained in the application for the exemption. This position appears to imply that the amount of detail contained in the application for the exemption should emphasize the straightforward operation of the holding company (and its FDIC-insured subsidiary)—which means that effort must be put into describing the holding company's operations in sufficient detail so as to qualify for the exemption.

Moreover, we strongly believe that advance consultation with the FRB and the FDIC regarding the content of an application for an exemption is critically important, lest a holding company file at the latest possible date and have its application rejected (whereupon it would be required file a comprehensive living will).

### Living Will Compliance Approaches

In order to address the challenges of preparing a living will, several steps should be considered as part of an overall project management approach.

First, the holding company should identify the functional unit that will be responsible for leading the project effort. In that regard, our experience to date indicates that the audit or risk management function is very frequently the preferred choice. Financial reporting and information technology units should be included as critical team participants.

Second, the project team should engage in a mapping exercise that begins to address the various items identified above for bank and non-bank assets, with particular emphasis not on enterprise-wide operations, but rather, on individual corporate separateness, ownership and control of the enterprise's operations and business functions.

Third, having completed an initial mapping exercise, at a very early stage in the process consultations should occur with the FRB and FDIC to elicit comments on the degree and scope of discussion and analysis that might be expected. At this juncture, experts on the various insolvency laws should become active participants in the project team.

Of critical importance in regard to discussions with the FRB and the FDIC is timing—particularly if the holding company intends to apply for permission to file a tailored living will. This is because it is likely that the amount of detail required to be included in a tailored living will be negotiated on a case-by-case basis with the FRB and the FDIC.

Fourth, assuming that a comprehensive living will must be prepared, the holding company must draft the recovery and resolution components of its living will, including necessary stress testing and other requirements that might be imposed by the FRB and the FDIC. (As indicated above, the documentation supporting the living will analysis is extensive, and requires months to organize and to prepare.)

### Observations and Conclusions

Because the filing requirements for living wills for holding companies required to file in July and December of 2013 are now on the radar scope of many institutions, we offer the following observations:

Both the FDIC and the FRB have not yet completed their reviews of the first set of living wills that were submitted by the largest U.S. and international banking institutions in July of 2012. Although those agencies have indicated that they might eventually issue some general policy guidance to the remaining universe of covered bank holding companies over the next 12-month period, we have been told that holding companies should not anticipate any such guidance in the immediate future.

However, the FRB and the FDIC have emphasized that they would encourage individual meetings to be held by all covered entities, and would provide individualized guidance in focusing the efforts of holding companies to submit living wills that meet regulatory requirements.

At the end of the day, we note that the process should be viewed as a series of negotiations to translate the parameters of the living wills regulation to the corporate and asset structure of individual holding companies and their subsidiary depository institutions and affiliates. In that regard, members of Pillsbury's insolvency and bank regulatory teams are available to answer any questions raised by this Alert.

---

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

Joseph T. Lynyak III (bio)  
Los Angeles  
+1.213.488.7265  
joseph.lynyak@pillsburylaw.com

Rodney R. Peck (bio)  
San Francisco  
+1.415.983.1516  
rodney.peck@pillsburylaw.com

This publication is issued periodically to keep Pillsbury Winthrop Shaw Pittman LLP clients and other interested parties informed of current legal developments that may affect or otherwise be of interest to them. The comments contained herein do not constitute legal opinion and should not be regarded as a substitute for legal advice.

© 2013 Pillsbury Winthrop Shaw Pittman LLP. All Rights Reserved.